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Warburg, Paul Moritz

"Investment of American capital abroad"

[Washington? D.C.]

[1919]

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"Investment of American Capital Abroad"

REMARKS BY

PAUL M. WARBURG

AT THE DINNER OF

COUNCIL ON FOREIGN RELATIONS

NEW YORK, APRIL 2, 1919

28 March, 1920 - C.R.W.

"INVESTMENT OF AMERICAN CAPITAL ABROAD"

Remarks by Paul M. Warburg

At the Dinner of the Council on Foreign Relations, on April 2, 1919.

Sagacious direction of the flow of American capital into foreign lands, and of the influx of foreign securities into the United States, is one of the most important and at the same time most puzzling, features of our present banking problem. It is not merely a question of finance, but it is closely interwoven with the future development of our domestic and foreign trade and the trend of immigration, wages and prices.

We are all familiar with the underlying conditions that render so immediate and so burning this question of "Investment of American Capital Abroad." It is unnecessary, therefore, to review in detail the changes in our economic position resulting from the world war. We, around this table, appreciate fully the duties that now are ours in consequence of the attainment of a position of such overtowering economic strength as to place other nations,—with whom, both for their sake and ours, we must continue to trade,—in a position of having to make good to us an annual debit trade balance larger than they may be able to settle by the shipment of goods or gold. In these circumstances, it is inevitable that such foreign customers must either sell us other foreign securities or assets they now hold, or their own national obligations, or failing that, they must make money so attractive within their own boundaries that our capital will seek investment there. To the extent that, during the next years, at least, these processes will be facilitated, our foreign trade will grow, and inversely, to the extent that this flow of capital and securities is impeded, our foreign trade will be discouraged.

It is impossible to weigh at this time the relative importance of the services our capital may render at home or abroad. Moreover, even were we inclined to consider the problem from a purely selfish point of view, it is obvious that we are not dealing with a moot question, but an actual condition—The balance in our favor exists today and it will remain to be squared every year, unless, indeed, we contemplate that the peace settlement will provide for a cancellation of the approximately ten billion dollars advanced by us to nations associated with us in the common struggle. Personally, I do not believe that a cancellation of this sort will be proposed, but I believe we should be prepared for some years to come to facilitate the remittance to us of the approximately $500,000,000. which annually will be due the United States on account of interest on its foreign loans.

Relief of this kind could be brought about by a scheme somewhat on the lines of "funding operations." That is to say, the debtors should be permitted to pay the creditor not in cash, but by the sale of additional long term bonds. This would give our friends abroad a most valuable "breathing spell" within which to adjust themselves to the new conditions. What form exactly such operations might take is impossible for us to predict. It is conceivable that Congress might authorize the Treasury to accept such foreign government bonds in lieu of cash, the United States in turn raising the corresponding amounts for the payment of its coupons either by borrowing in the market, or by taxation, or by offering these foreign bonds to the American people. If Congress should be unwilling, or where our foreign debtors prefer to do so, they might raise the necessary funds as far as feasible by the direct sale in the American market of their government securities, the proceeds being used to provide the amounts due for the payment of the coupons.

I believe I am safe in saying that in planning for the future, the country will favor a policy of using wherever practicable, the natural channels of individual effort rather than action by the government. Wherever government enters business or finance, the natural basis of cost of production is quickly neglected, and resulting deficiencies are made good by taxation. Taxation, on the other hand, has reached such unprecedented scope, and, if perpetuated in its present extreme form, may have so disastrous an effect upon the future development of our country, that no step would seem advisable which would unnecesasrily push us further in that direction. It would, therefore, be preferable, as far as possible, to work for a direct absorption of these foreign loans by the people instead of having them rest in the possession of our government.

We must bear in mind, however, that the absorption of these annual remittances of approximately $500,000,000. forms only a minor part of the problem. Foreign countries, in addition, will require many hundred billions worth of raw material and finished articles, for which, in their present disorganized condition, they will not be able to pay by the sale of goods or services. Conditions abroad, in some countries, are so grave and alarming that we must frankly admit our inability, or even unwillingness, at this time to come to their support. There are others where we should feel justified and glad to help if only we could see our way clear eventually to open to them the avenues leading to American savings. In such cases the question would arise, could the American investor be made to comprehend the foreign situation? Could we awaken in him a sufficient understanding and confidence to make an appeal to him likely to meet with reasonable success? A three-fold difficulty awaits us in this respect; one, that in the United States the habit of saving and investing had not been sufficiently developed before the war. While great headway has been made during the last two years, it would be unreasonable to assume that the doctrine of thrift has entered deeply enough into the minds of our people to establish a permanent habit.

Second, taxation at this time is in effect confiscating the large annual accumulations by the wealthy classes that heretofore formed the bulk of the capital available for investments. A continuation of such policy of taxation would mean that the successful placing of securities in the future will have to depend largely upon far reaching distribution amongst those who will reap the benefit of increased income without

being subjected in the same degree to the burden of increased taxation, that is primarily amongst the wage earners. These in turn will only be able to perform this most important function of becoming the country's main investors if they are taught to use higher wages not for the purpose of indulging in greater luxuries, euphoniously called the "higher standard of living," but for the purpose of effecting greater savings.

And, finally; sucessfully to carry on this thrift campaign, or as recently it has aptly been termed "sensible spending," is, in itself, a task of very great difficulty. To steer the wage earner's savings directly into foreign investments—barring the securities of undoubted character of a few strong and familiar nations—would, however, be an undertaking beyond our power, and moreover, one of most doubtful wisdom. The wage earner, in making his investments, has no time nor ability for study and discrimination. Grave danger exists, therefore, that advantage might be taken of this circumstance, and that crooked promoters and the like might rob him of his savings.

The small investor needs protection,—that is why in the past he resorted to the instrumentalities of the savings banks or the life insurance companies, who took it upon themselves to scrutinize and pick and choose on his behalf the investments to which his savings should be applied, and to give him an interest in a largely diversified investment where the risk had been spread. This consideration has led me to believe that it would be very opportune for us to consider whether at this juncture the creation of a large investment trust would not render a very timely service. Of course, it could not be considered a "cure-all;" the present problem is too large for that. The War Finance Corporation (which in its structure is an investment trust with a limited span of life and restricted powers) is expected to bring substantial relief and many other remedial measures will have to be devised. As one of these, however, a large investment trust, organized on a country wide basis, might offer the two-fold advantage of, on the one hand, bridging the interval necessary for the better understanding and further development of foreign propositions, and for the creation of a better market, while on the other

hand it would enable the small investor to buy the obligations of such investment trust, representing diversified holdings closely examined by the most competent people and guaranteed by a very substantial paid-in capital stock. This, however, is predicated upon the thought that such investment trust would be started upon a sufficiently broad basis to permit of a wide diversification and thorough investigation. It is obvious that no small concern could be liberal enough in incurring the heavy cost of through studies and examinations, and of employing the best experts. No investment trust would be safe or successful that would be forced to stint this item of expense.

We must not underestimate the difficulty of raising the capital required, and of creating an adequate organization for the sale of the trust's obligations to the smallest and largest investors all over the country. It would appear, however, that both our export industries and our banks would have a very vital interest in seeing a project of this sort materialize. He who controls foreign steam and electric railroads, telephone or telegraph lines, electric light plants, mines or other industries, is naturally best equipped to secure for his country the large orders for supplies that go with the maintenance of such plants, and the requirements of the people operating them.

Where foreign countries are unable to sell their own obligations either because their credit is not sufficiently well established, or because governments do not wish to increase their indebtedness to us, or because the limit has been reached of the amount of their own bonds that we can absorb on acceptable terms, they may have to choose between several courses:

They may increase their interest rates, and permit their foreign exchanges to fall in our markets to such a degree that the American dollar will eagerly cross the ocean tempted by these favorable terms of employment, or they may reduce their purchases from us, (and the higher the premium of the dollar in their lands, the more they discourage such inportations), or they may sell us the foreign plants and assets they own. There is a limit though to which a country may safely permit its foreign exchanges to fall and its money rates

to rise. If these limits are disregarded, distrust may be engendered strong enough to drive foreign money out instead of drawing it into the country. There is a limit, too, down to which a country may restrict its importations of raw materials. Many a country may be expected, therefore, to reach the point where it may prefer to sell its plants or assets in other foreign lands, or offer us a joint ownership in them, or a partnership in new enterprises at home or abroad. Just as much as European capital crossed the seas and developed the transportation systems in North and South America, in Africa, India and China, so the time has now come for American wealth to do its share in rebuilding the world, and to open new avenues of enterprise whenever—or must we say if ever?—political and social conditions settle down to a fairly normal state.

This dream, predicated upon the ending of a nightmare, cannot materialize, however, unless our men go out into the world and study carefully, courageously and sympathetically conditions and opportunities in foreign lands.

It would appear as if the Export Associations, now being organized in large numbers, would soon realize that it will greatly facilitate the finding of new markets for their wares if in payment the foreign purchaser can sell us some assets that he holds. Active trade, in turn, will foster intimate banking relations, and nothing would seem more natural and logical at this time than to see the banks and these export associations, or the elements constituting them, combine in organizing an instrumentality for the study and financing of these foreign propositions in anticipation of the moment when tested and matured they may be absorbed by the American investor.

The time for immediate operations of such a trust has not yet come. With us the Victory Loan must first be placed and fully absorbed before we may find the basis for our future investment operations; the transportation question must be solved, reestablishing $18,000,000,000. of railroad securities on their proper level, and the sale of the ships now held and being constructed by the government must be financed, before investment funds may become available for the purposes

I have outlined on terms attractive enough to permit comprehensive operations. In order to reach a sound and solid level, it will be important, moreover, that England, as soon as her large governmental borrowing operations are completed, free her money market from all artificial influences. The removal of the peg in the Sterling market appears to indicate a policy in that direction, and to forebode the next step, long advocated by Lord Cunliffe, of establishing higher discount rates.

The immediate future is subject to too many acts of God and man, to permit us to indulge in prophecy. but it is safe to say that the flow of American capital into foreign investments cannot be expected to take large proportions until both here and abroad governmental finance operations have fairly reached their end, and money rates are permitted to find their own level, and, incidentally,—another little factor not to be overlooked,—until peace has been signed and made effective. When these conditions are fulfilled, our investment rates ought to begin to trend downward, while England's rates might move upwards to more closely approximate ours. A solid basis for harmonious and intimate cooperation will then have been reached between the two countries on whom, in the near future, the main burden will rest of financing the world's trade and further economic development.

While thus the moment for comprehensive foreign operations seems still remote, let us hope that the interval may pass sooner than most of us think. In any case, it is none too soon to prepare for that eventuality. It is easy enough to run along with the crowd that buys at top prices when things are booming, but the true art is to be able to discriminate and to discern the objects of permanent value when the outlook seems darkest. When the political horizon will clear up, American business genius and courage will find the greatest opportunity it ever had. However, let us bear in mind that we are not dealing with a simple business proposition, but that ability to act at the proper time may bring hope and cheer to those looking to us for support, while unpreparedness and unnecessary delay will entail continued suffering for

INTENTIONAL SECOND EXPOSURE

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those on whom the hand of fate has rested heavily during these dark four years.

I have addressed myself somewhat onesidedly to only one feature of the large problem. Within the compass of my ten minutes' remarks, and without abusing your patience, it is impossible to do more. I am fully conscious of the fact that it must be our ultimate ambition to create a direct wide market for foreign securities, and to use the indirect method of an investment trust merely as a useful auxiliary. If such broad market is to be developed, the fullest protection of our people is a prerequisite. It means that, on the one hand, it is essential that we may confidently rely upon the unreserved sympathy and support of our government in protecting our rights in foreign lands; on the other, that measures must be taken to protect the small investor from the lures of reckless promoters, such as now over-run the country offering worthless securities in exchange for Liberty Bonds. I had hoped that in every Federal Reserve District a voluntary "Capital Issues Committee" might be organized which might certify to the bona-fides of a prospectus, and that we could train the public to distrust any offering made without such certification. Failing the establishment of some such voluntary organizations, I am confident that Federal Legislation will sooner or later be invoked resulting in red tape and delay such as, in the long run, are apt to be caused by rigid governmental control.

If broad open markets for foreign securities are created, I hope that our bankers will insist on receiving bonds payable not only in dollars, but also in the currency of the country issuing the security. We should have international bonds rather than foreign bonds. While for many years to come the home market for such securities may be of very little importance to us, we cannot foretell what the future may bring. We know, however, that for England it proved of the greatest value that in her hour of need she owned billions of foreign securities enjoying markets outside the British Isles. while France suffered from the fact that her loans to foreign lands had been made in special issues payable in francs, and

having their exclusive market in Paris. International security markets are healthy adjuncts of international discount markets, they are important equalizers of trade balances and I trust that we shall not neglect to provide this important part of Uncle Sam's equipment for his new career as a world banker.

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